

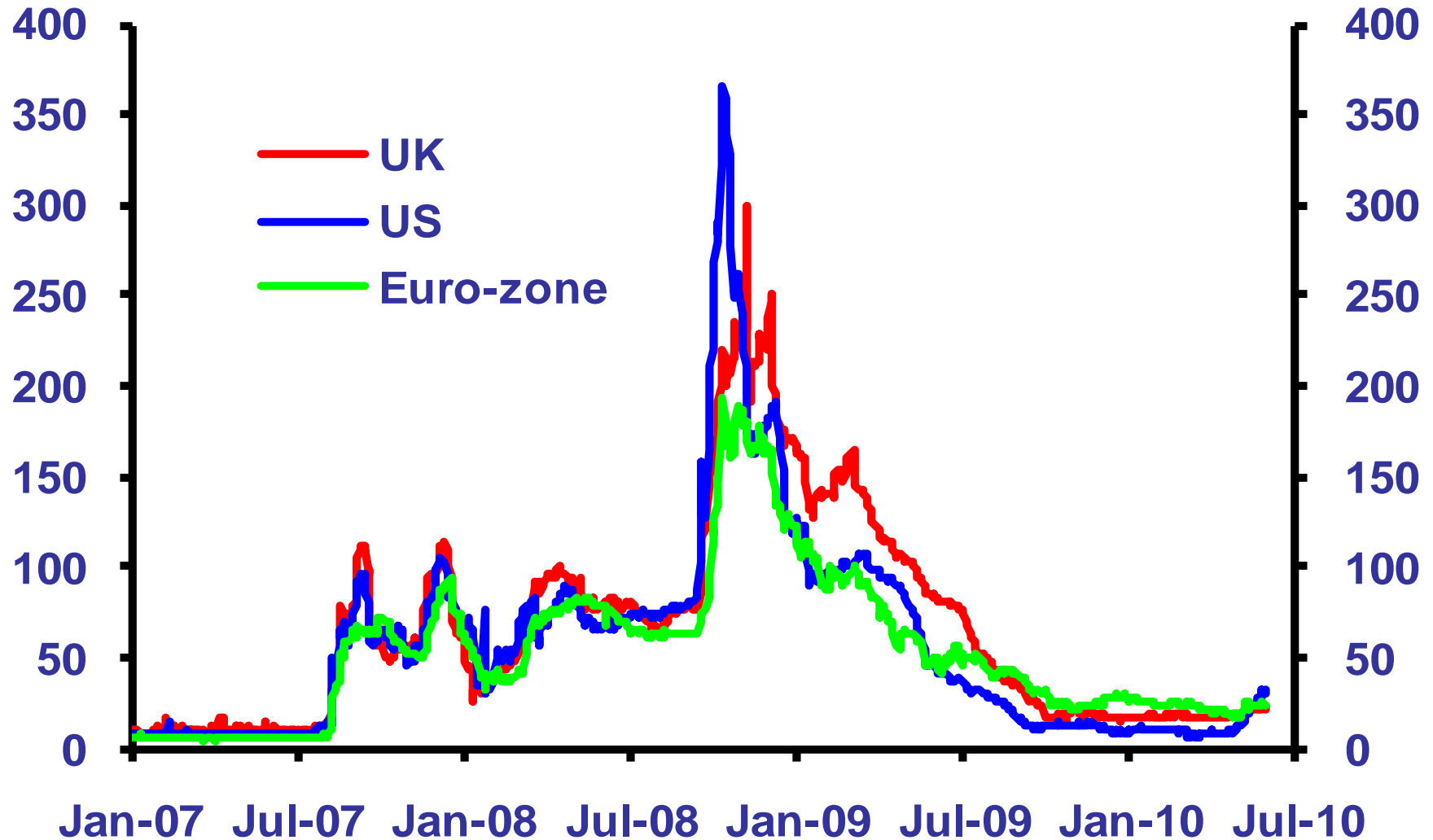
Is the Crisis Over?

By

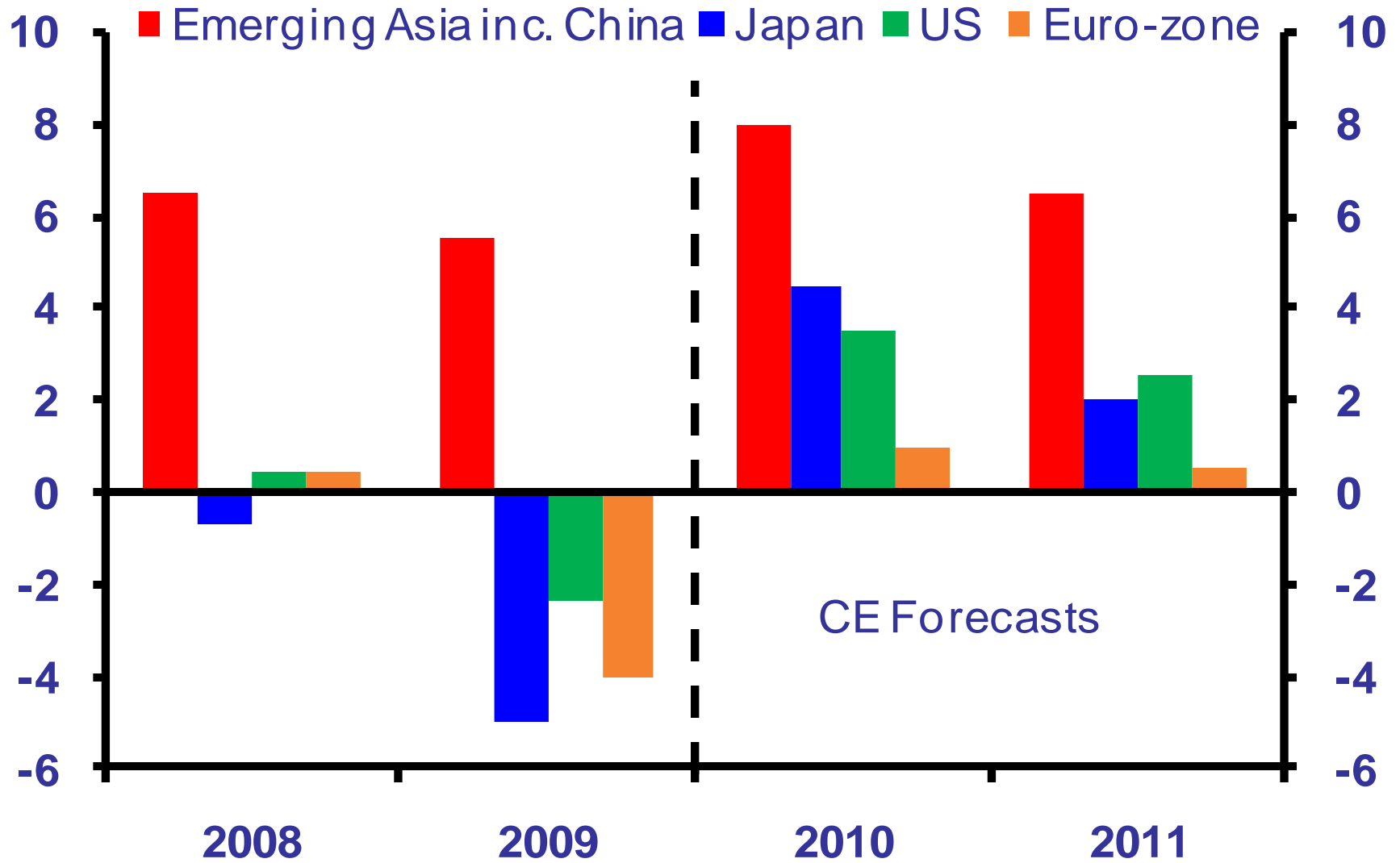
Roger Bootle



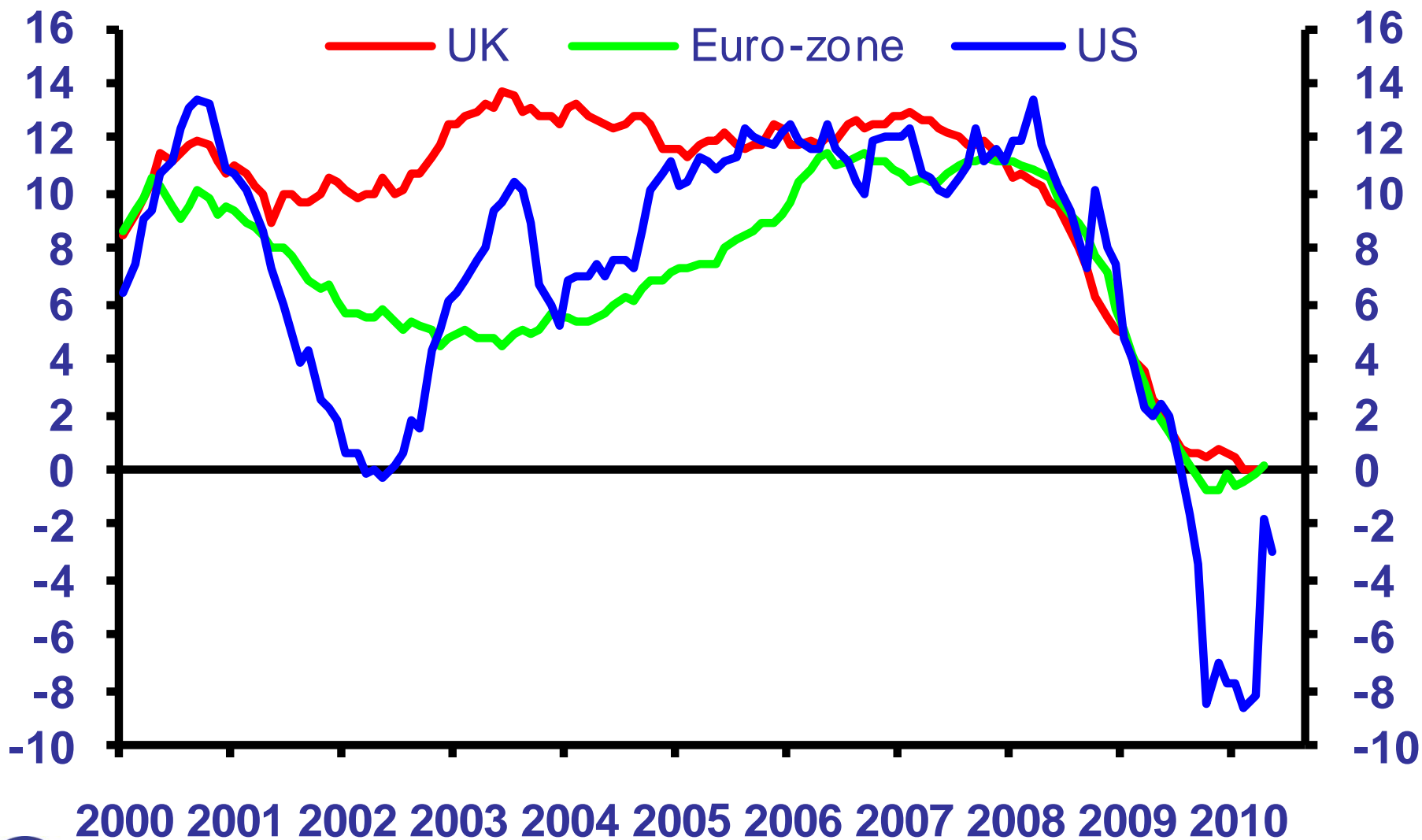
1. The risk spread that banks require to lend to each other (bps) (2007-2010) (Latest = 1 Jun)



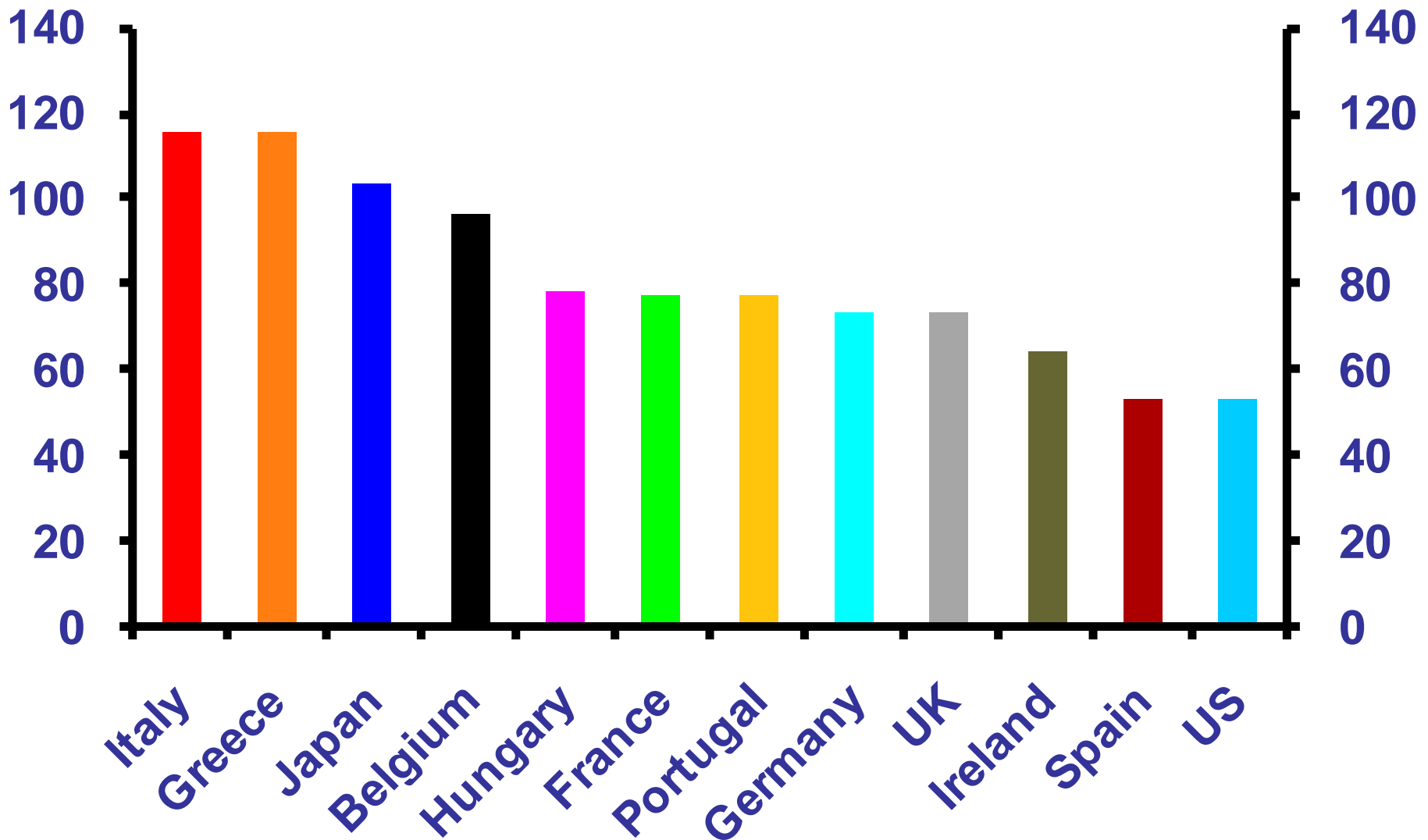
2. GDP (%y/y)



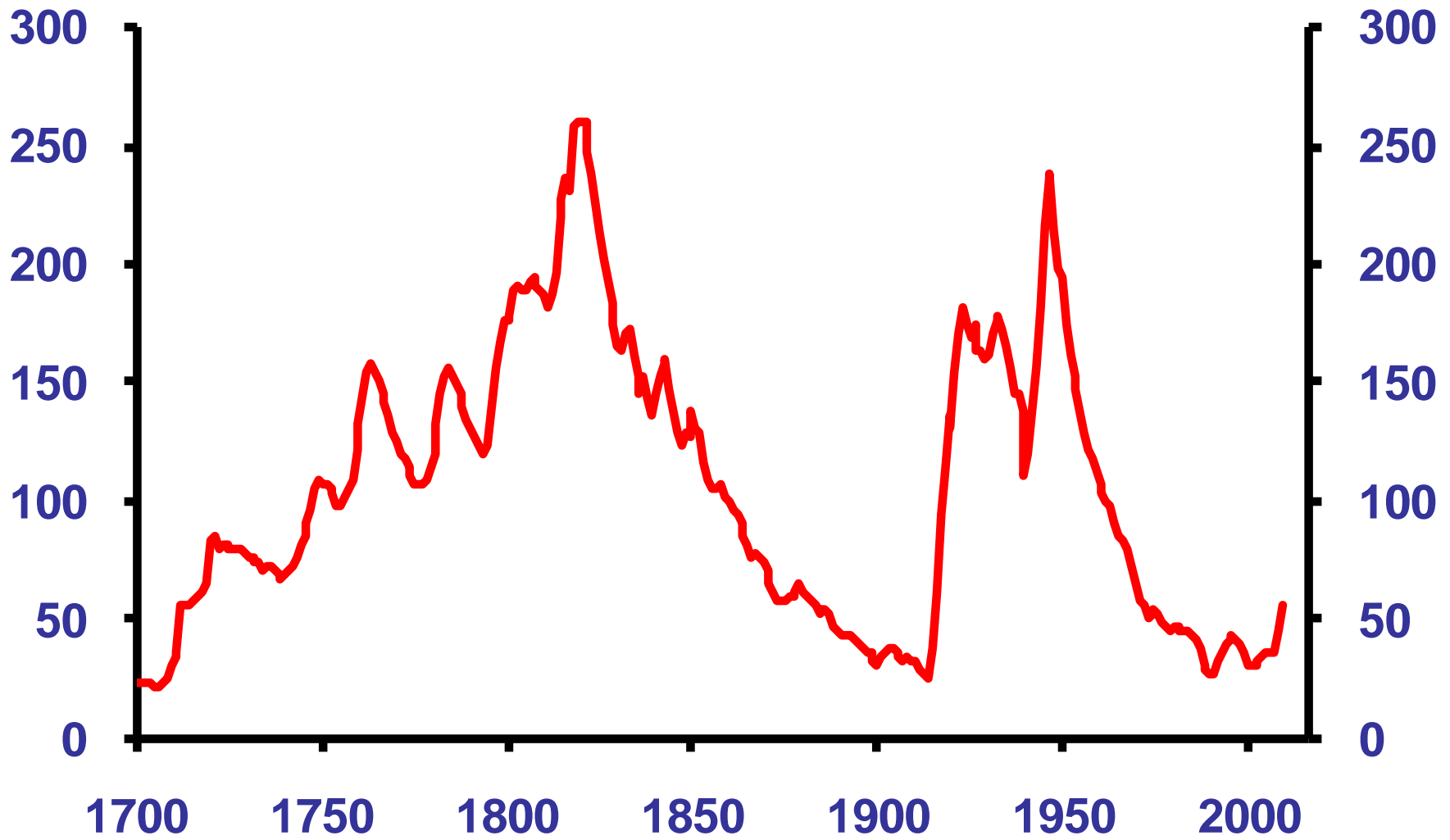
3. Bank Lending (% y/y) (2000 - 2010) (Latest = May)



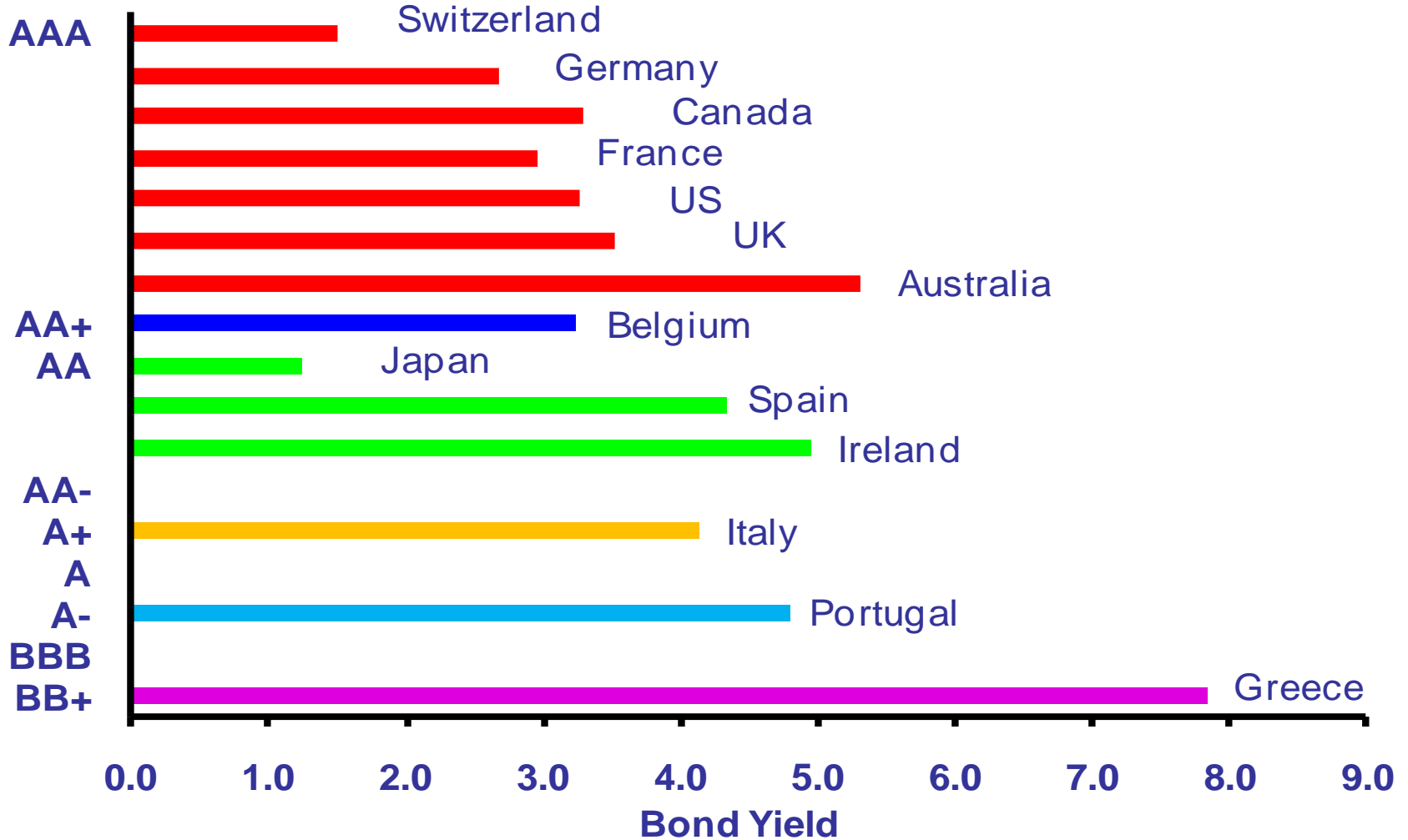
4. Government Debt to GDP (%) (2009)



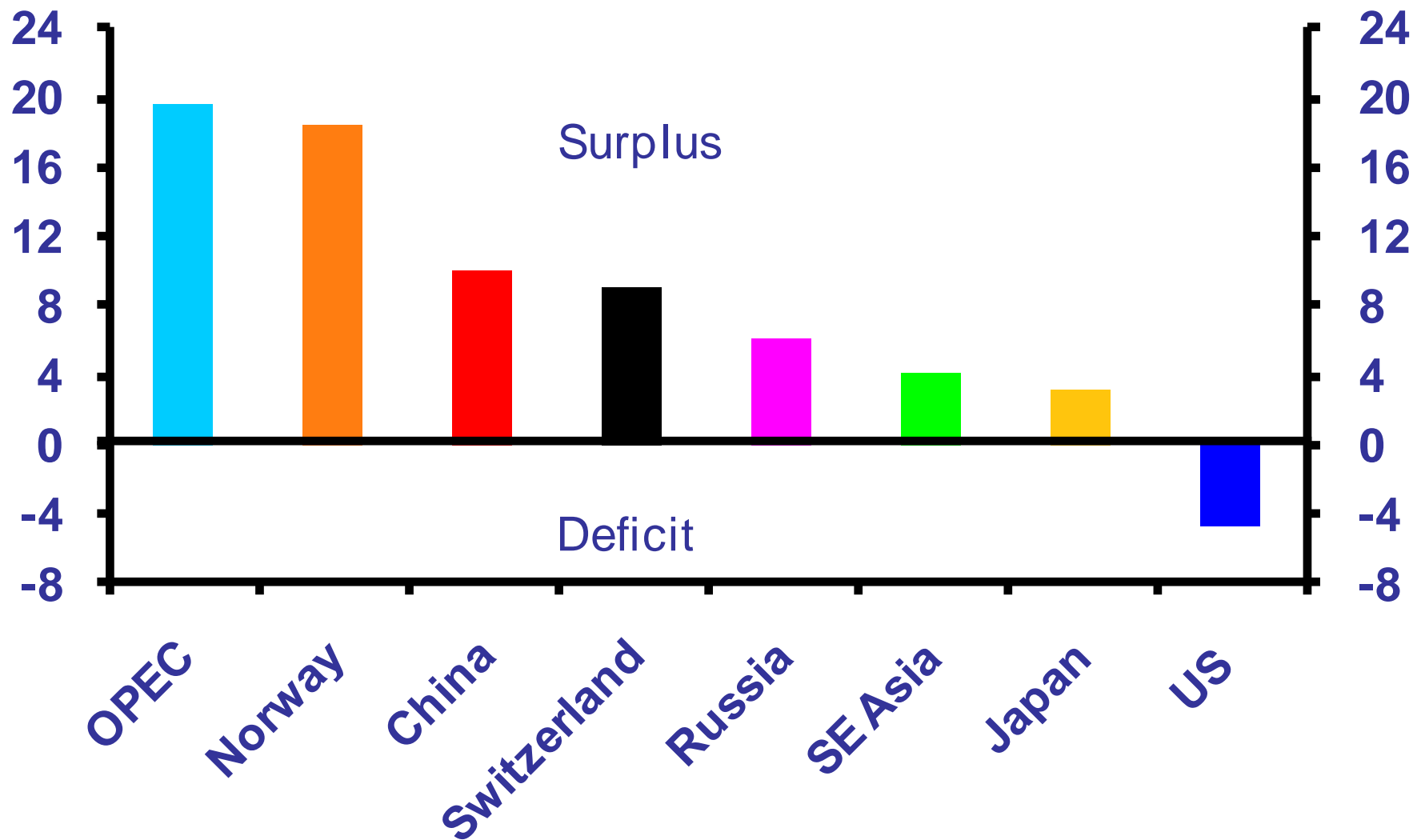
5. The Long History of UK Gross National Debt (as a % of GDP) (1700 – 2009)



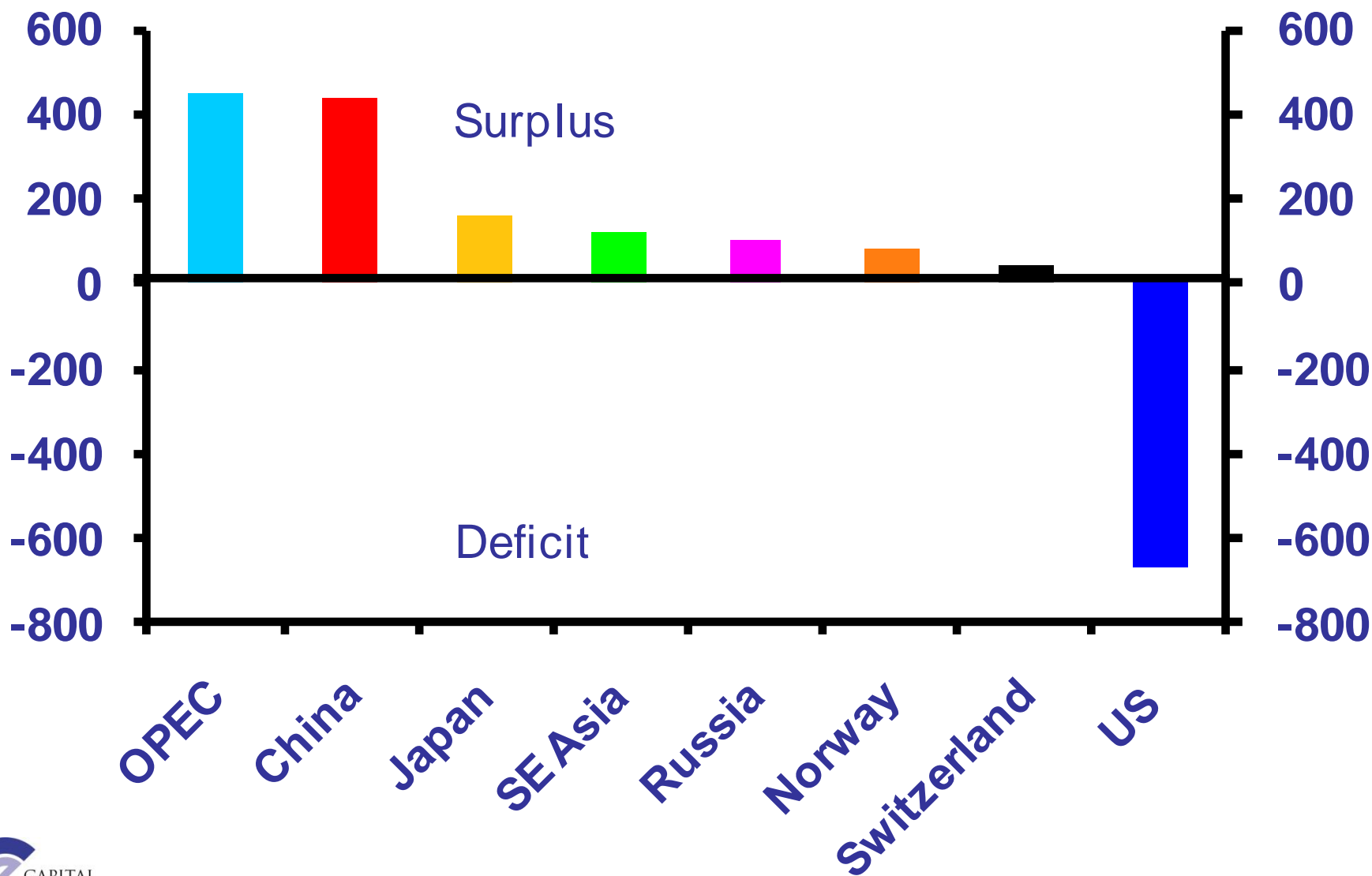
6. Sovereign Credit Rating & 10-yr Bond Yield (%) (1 Jun)



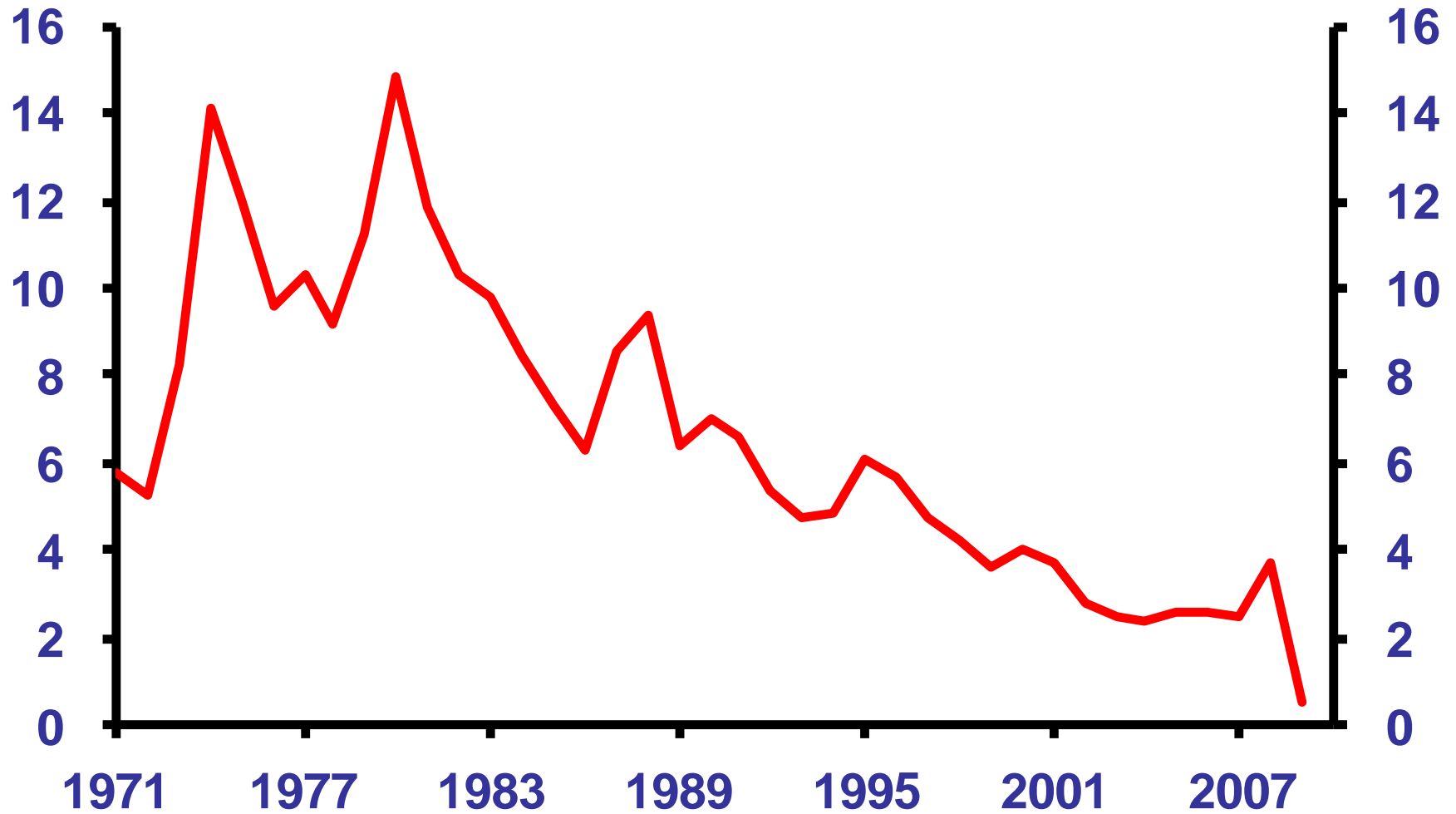
7. Major Current Account Imbalances (As a % of GDP) (2008)



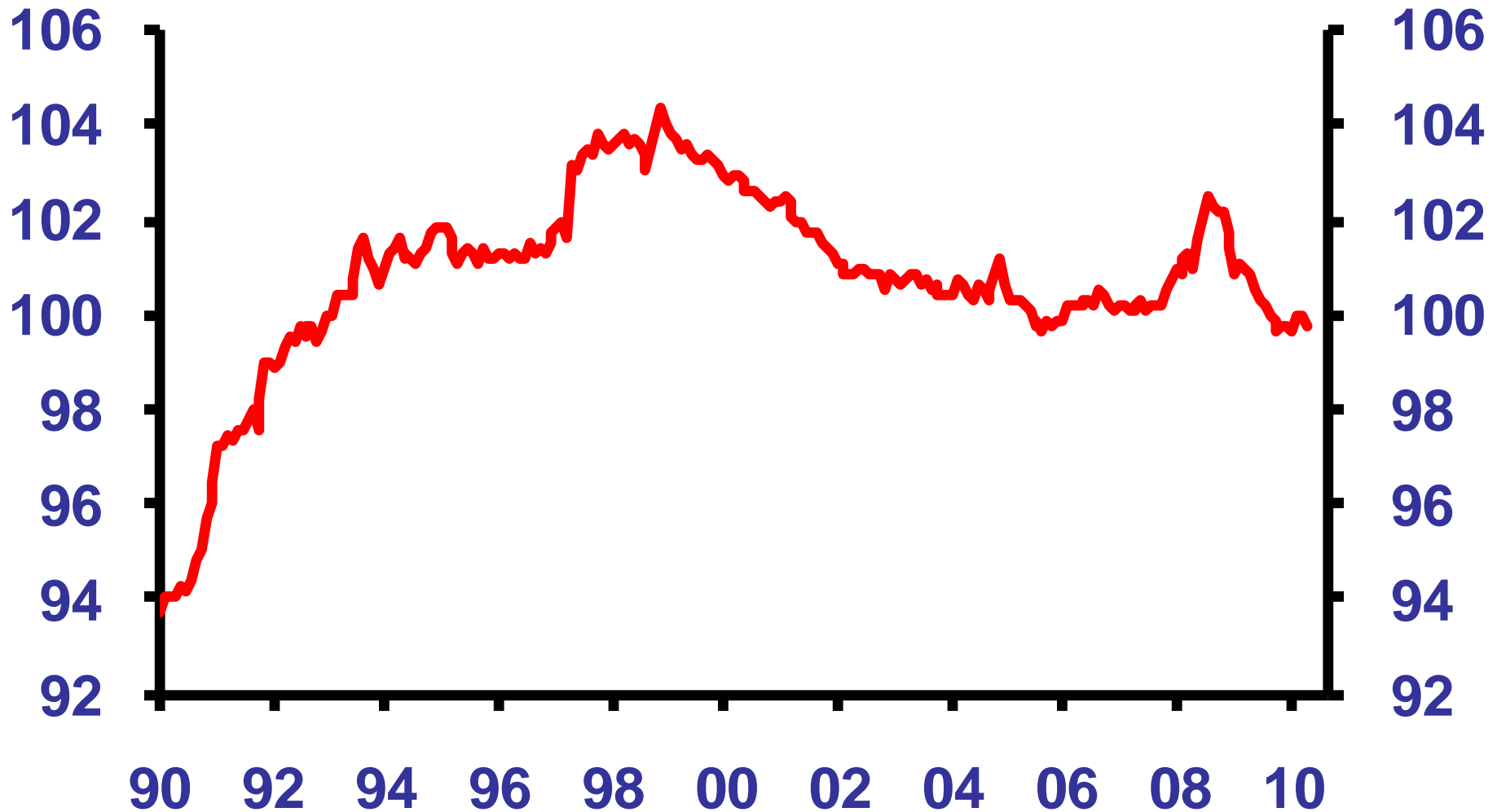
8. Major Current Account Imbalances (US\$ bn) (2008)



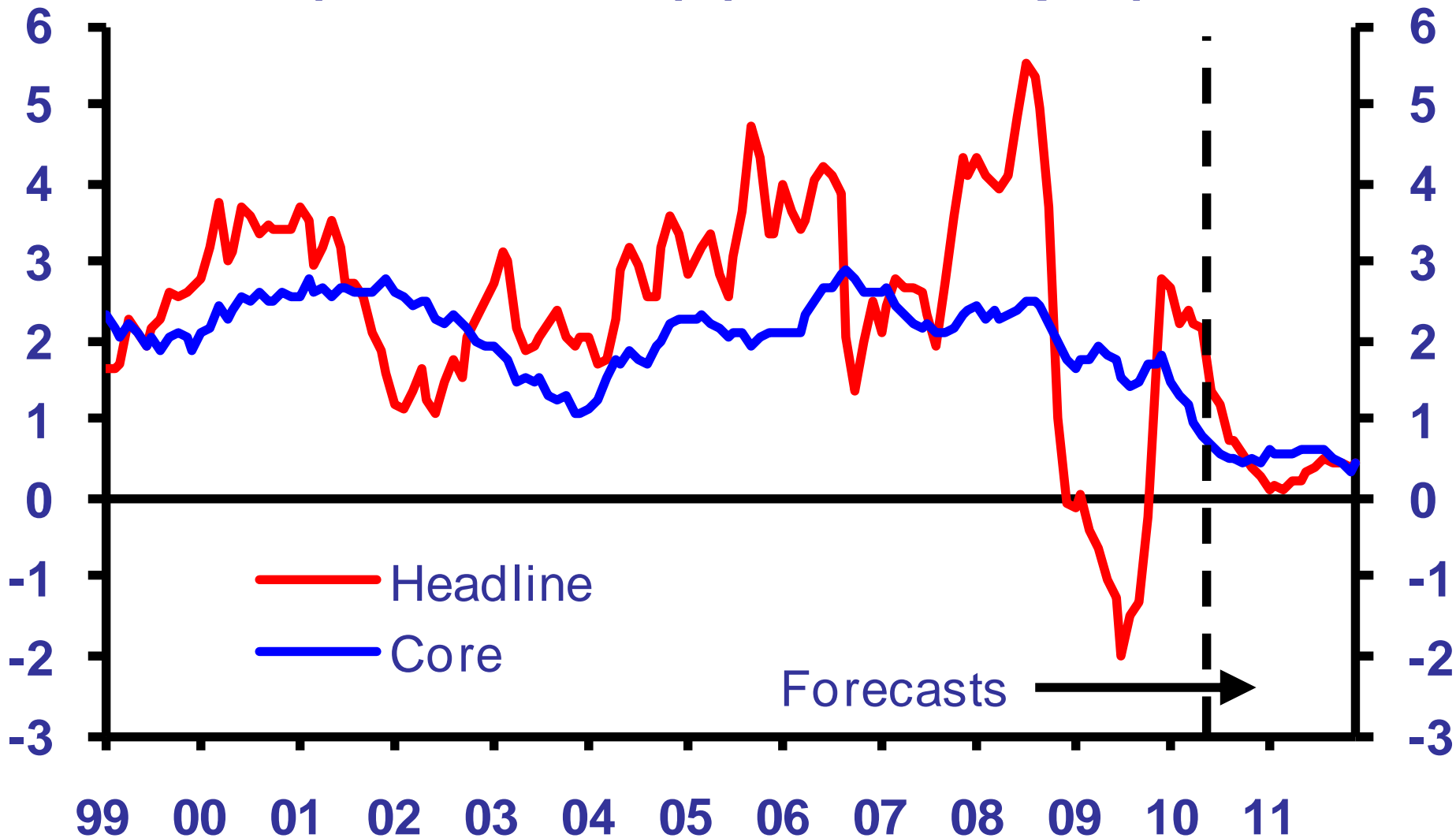
9. OECD Inflation (% y/y) (1971 - 2009)



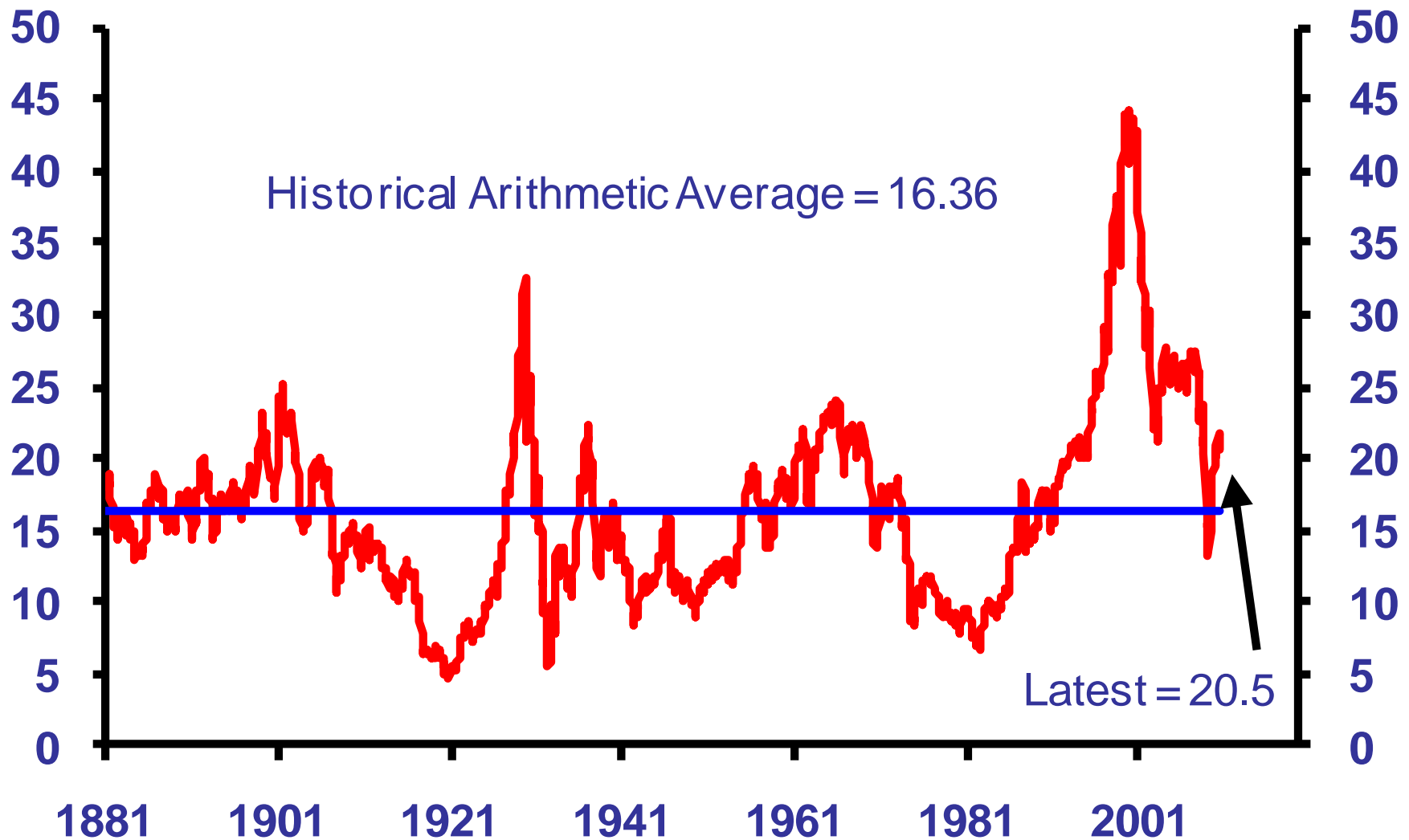
10. Japan Consumer Price Index (1990 – 2010) (Latest = April)



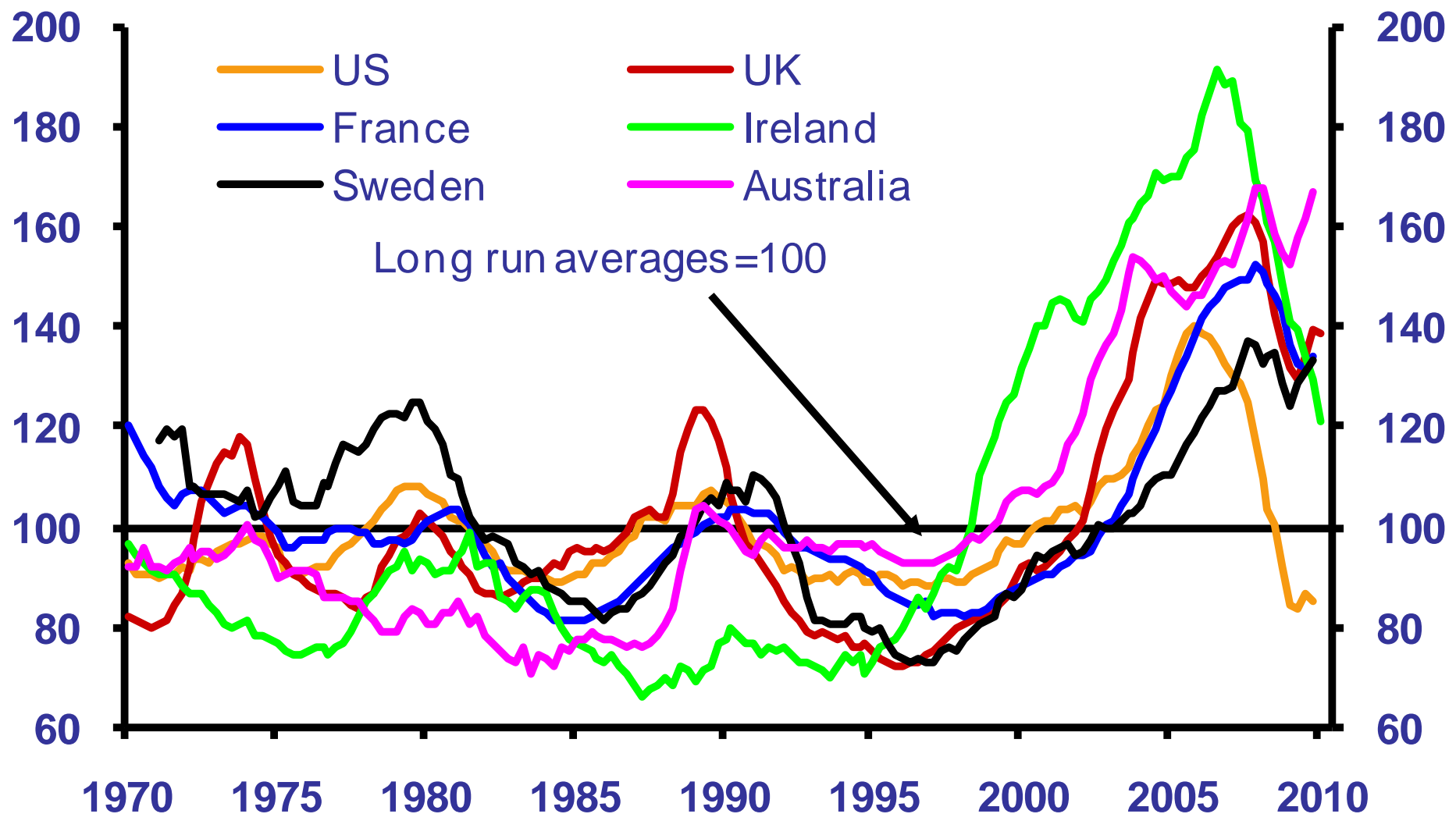
11. US CPI Inflation (% y/y) (1999 – 2012) (Latest = April)



12. US PE Ratio (Earnings 10 Year Average, Real Terms) (1881 – 2009) (Latest = 1 Jun)

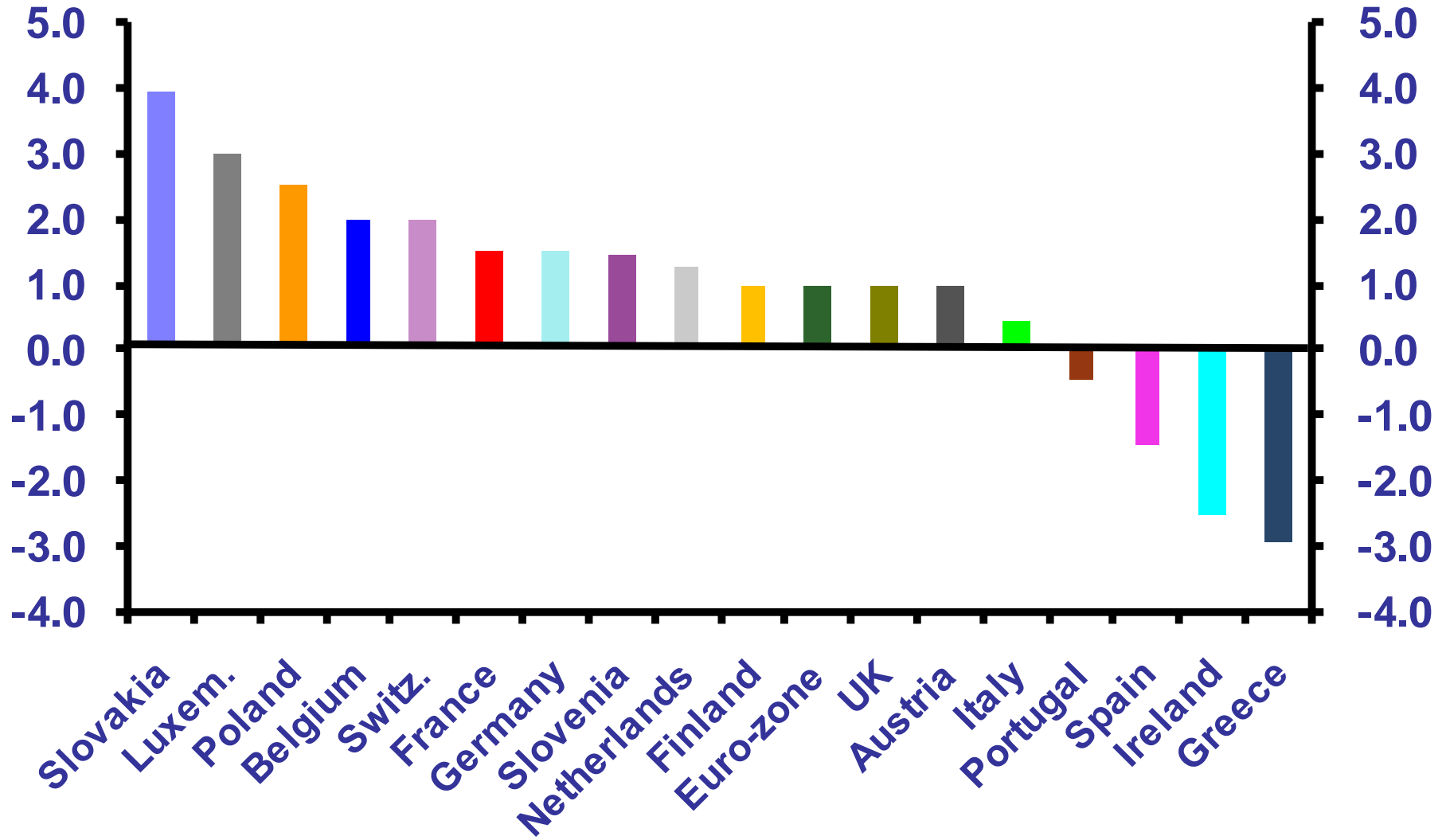


13. House Price to Earning Ratios (Index Long Run Average = 100) (Latest = Q1 10)

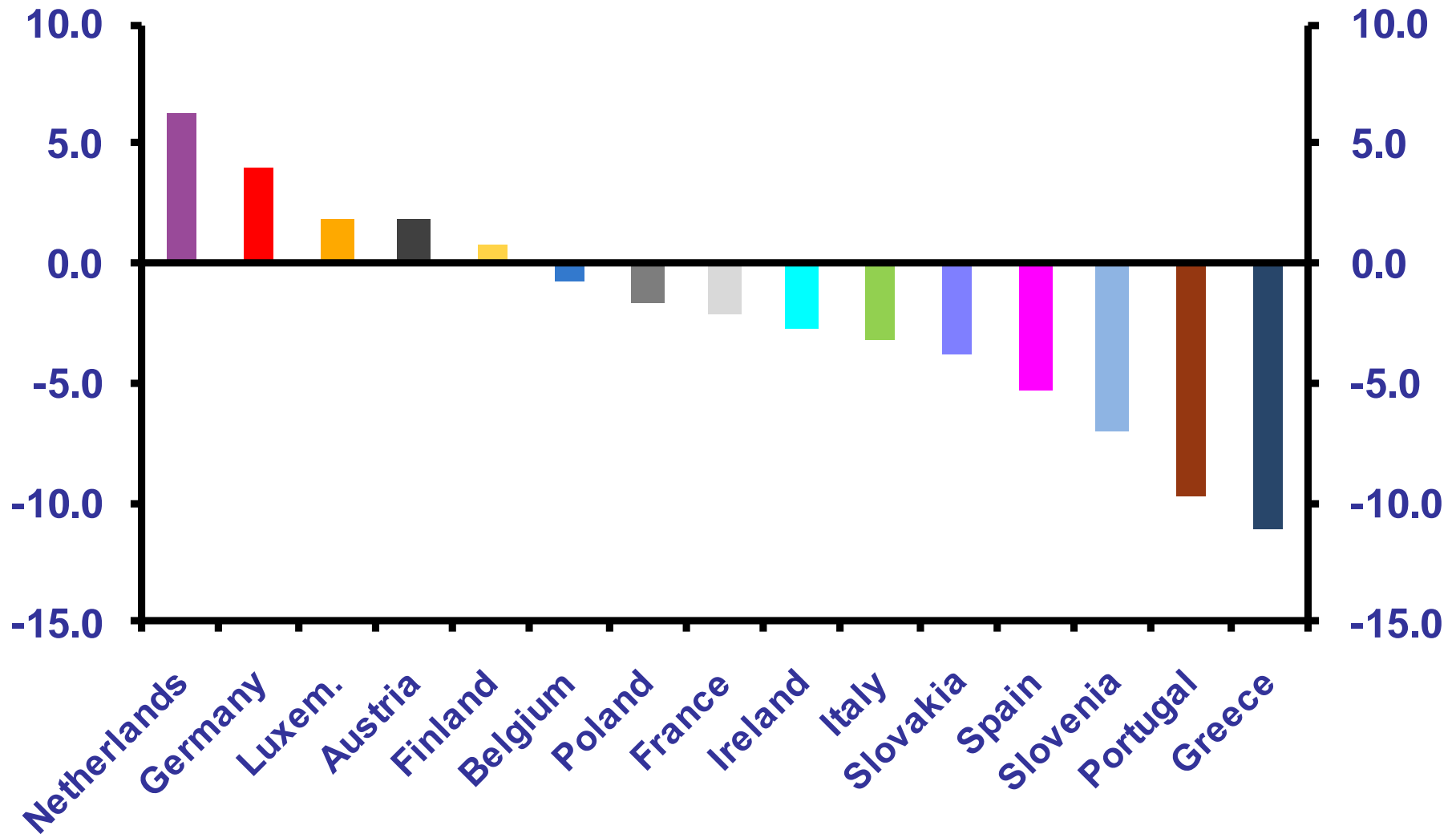


Sources: Thomson Datastream, Capital Economics

14. European GDP Growth (% y/y) (2010)

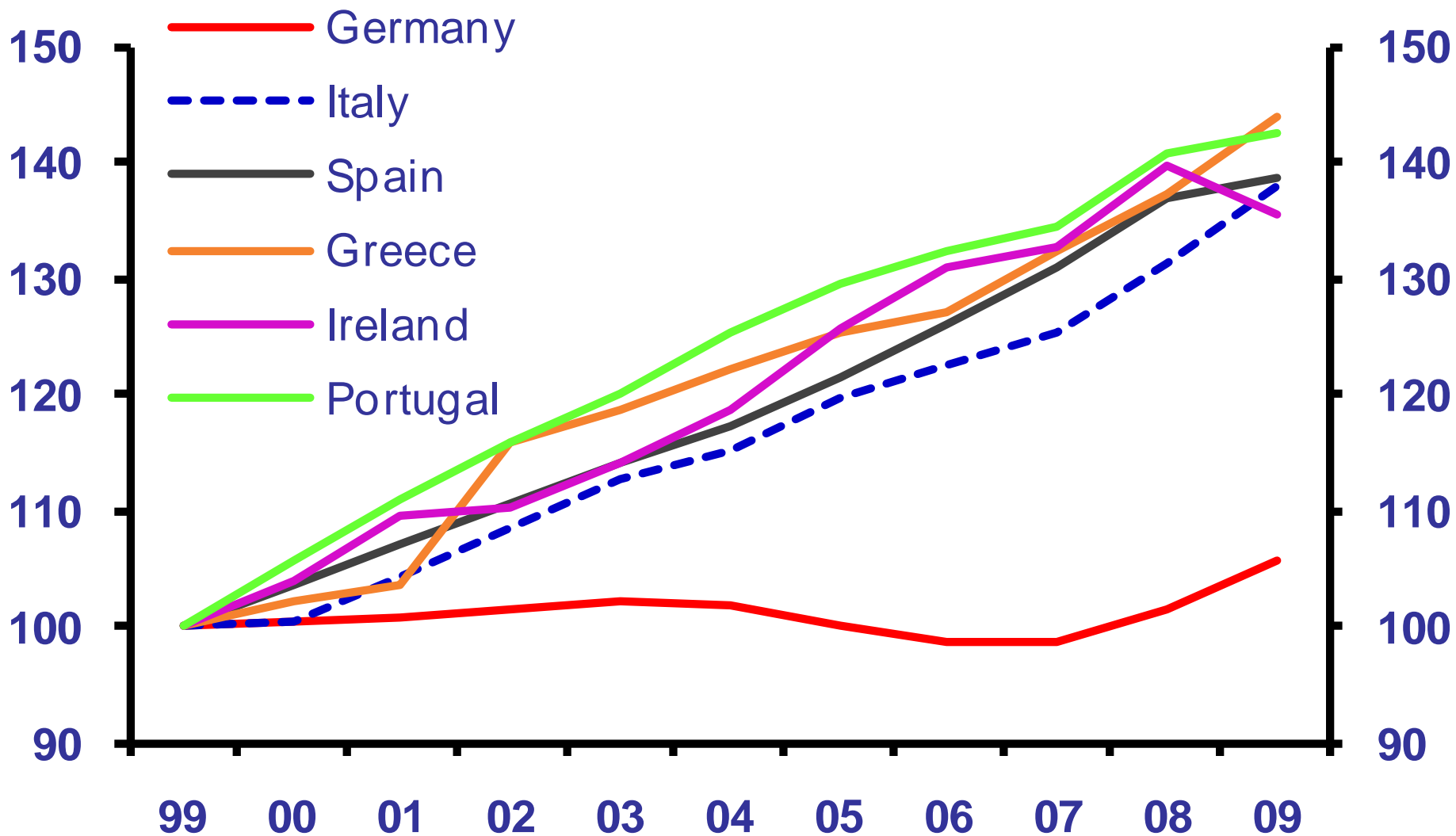


15. Current Account (% of GDP) (2009)

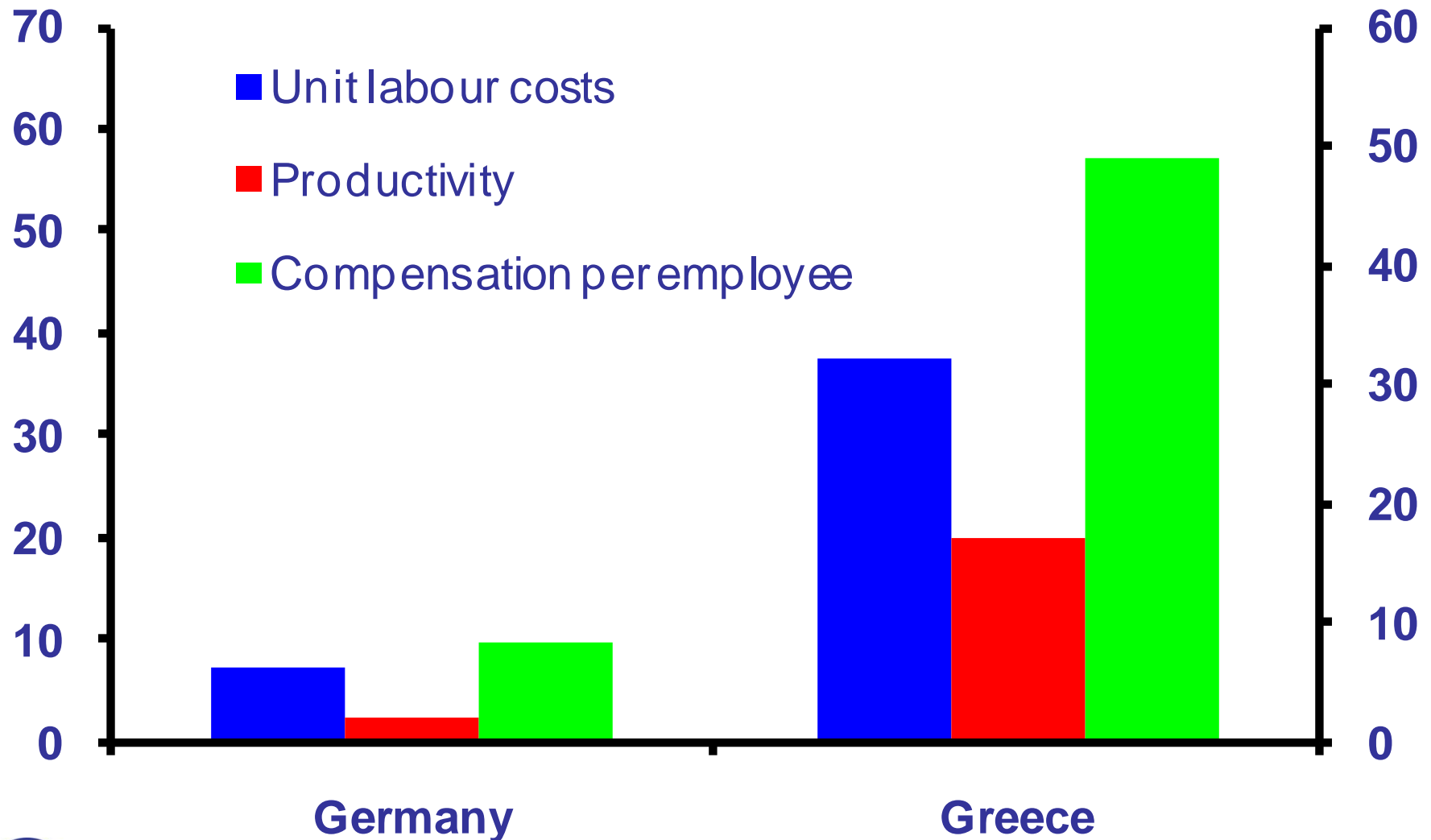


Sources: Thomson Datastream, Capital Economics

16. Unit Labour Costs (1999 = 100)



17. Productivity and Labour Costs (% Change Q1 2000 – Q4 2009)



18. Past Major Fiscal Adjustments

	Primary Balance (% of GDP)			Ave. GDP growth
	Trough	Peak	Ave. ann. adj.	
Ireland (81-89)	-6.4	+3.9	1.3	3.1
Canada (83-89)	-6.3	0.0	1.1	3.9
Belgium (83-90)	-5.8	+4.0	1.4	2.5
Greece (84-94)	-6.1	+3.8	1.1	1.4
Sweden (93-98)	-9.9	+3.9	2.8	2.3
Finland (93-00)	-8.7	+7.8	2.4	3.8
UK (93-00)	-5.5	+6.0	1.7	3.3
Greece (09-13)*	-7.7	+2.6	2.1	-0.3

* Capital Economics estimate, official primary deficit forecasts are unavailable

19. Key Greek Forecasts (% y/y)

	2010	2011	2012	2013	2014
<i>GDP</i>					
Ministry of Finance	-4.0	-2.5	1.1	2.1	2.1
Consensus Economics	-2.6	-0.5	-	-	-
Capital Economics	-3.0	-3.5	-2.5	-1.0	-0.5
<i>CPI</i>					
Ministry of Finance	1.9	-0.4	1.2	0.7	0.9
Consensus Economics	1.8	1.6	-	-	-
Capital Economics	3.3	0.8	0.0	-0.5	-0.5

20. Greek Unit Labour Cost Adjustment

Greek Productivity	Greek Wages	Greek ULC	Euro-zone ULC	Years to get 20% ULC fall	Years to get 30% ULC fall
<i>Baseline</i>					
2	0	-2	1	8	10
<i>Stronger Greek wage growth</i>					
2	0.5	-1.5	1	9	12
<i>Weaker Greek wage growth</i>					
2	-1	-3	1	6	8
<i>Weaker euro-zone unit labour cost growth</i>					
2	-2	-4	-1	8	11

21. Fiscal Consolidation (2013 – 2025)

(Assuming average interest rate paid by the government = 4.5%)

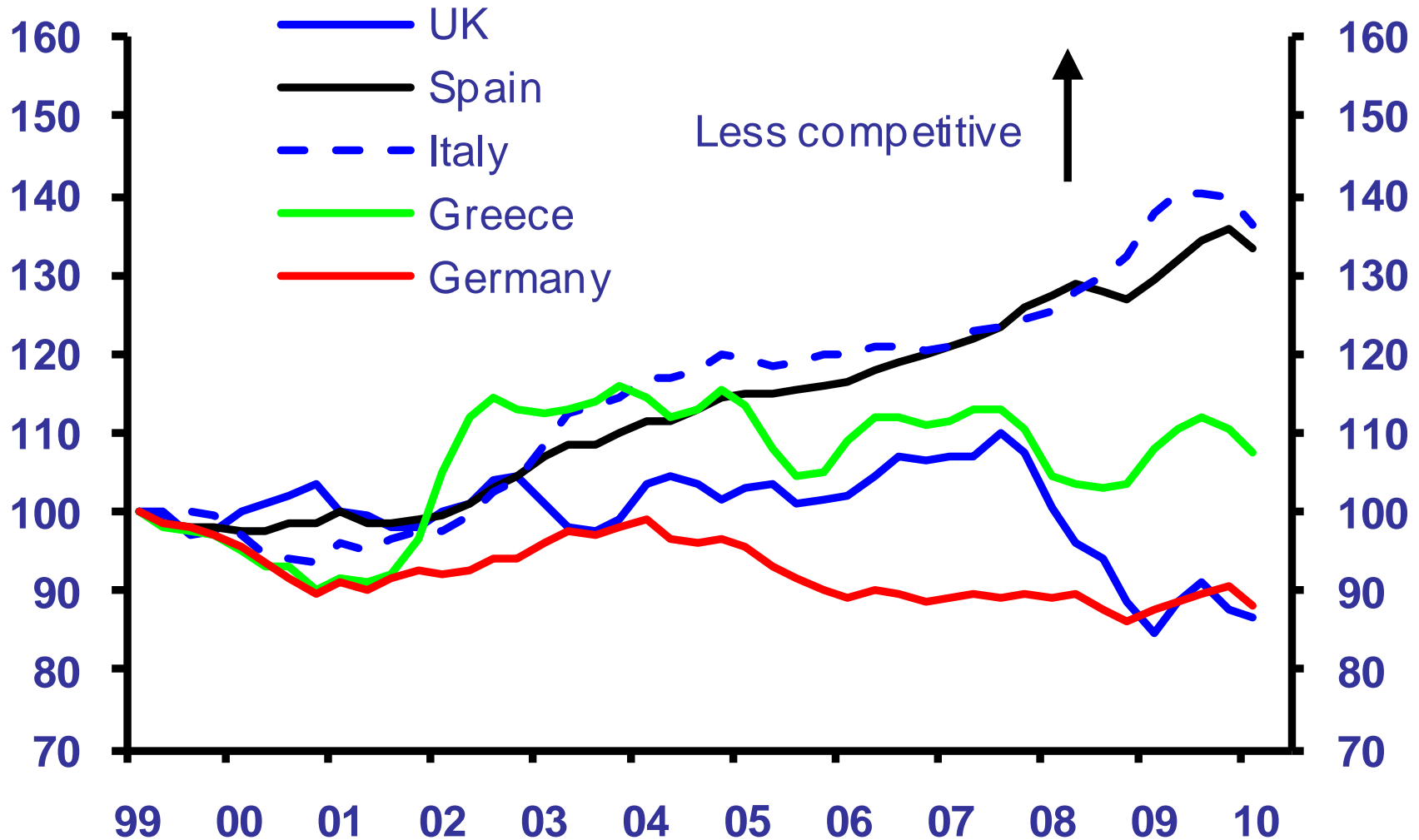
LR nominal GDP growth (% y/y)	Primary surplus for debt-GDP ratio at 150% of GDP	Primary surplus for debt-GDP ratio at 115% of GDP
-1.0	8.3	10.2
0.0	6.8	8.5
1.5	4.4	6.7
2.5	2.9	5.3
4.5	0.0	2.7

22. Fiscal Consolidation (2013 – 2025)

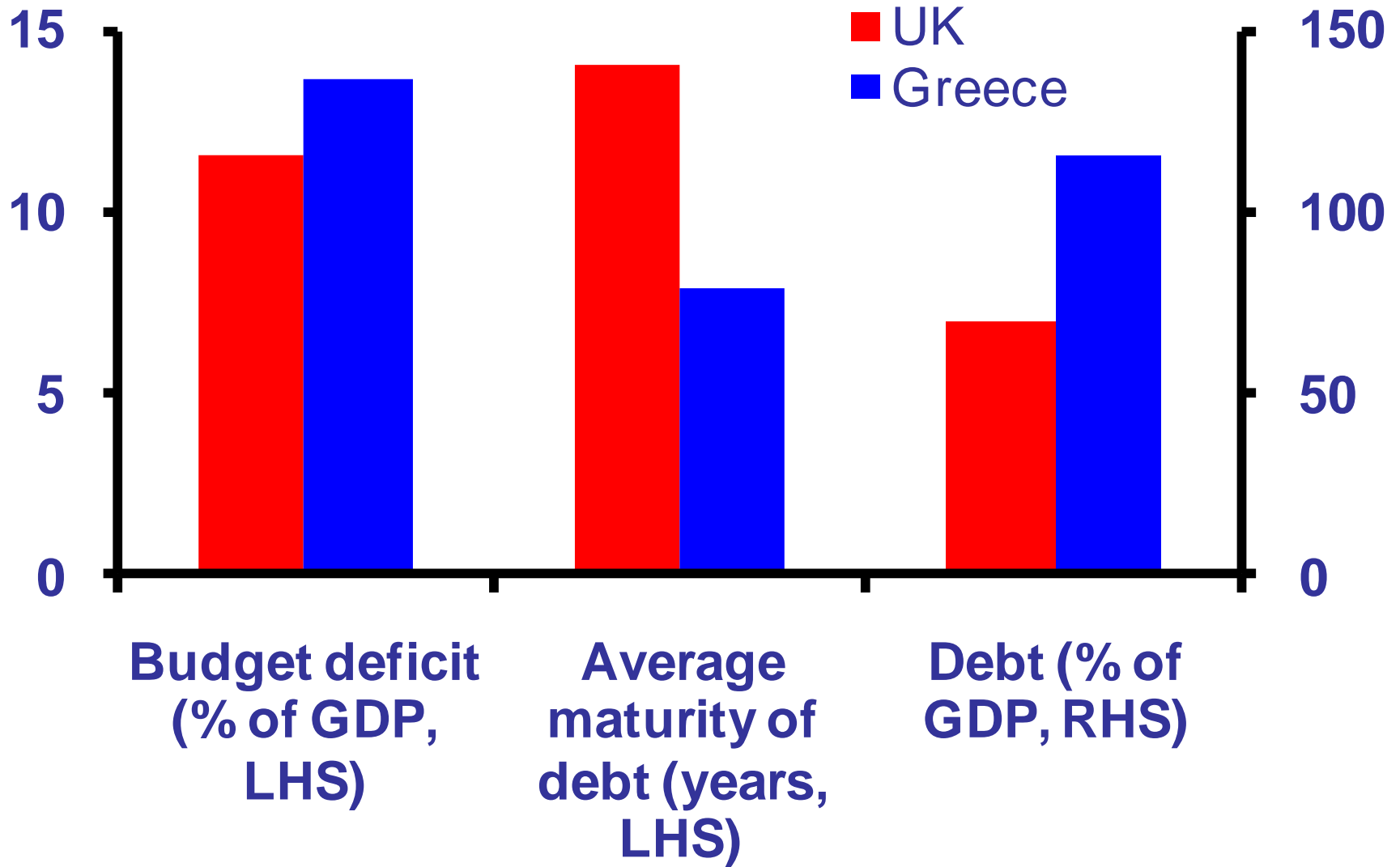
(Assuming average interest rate paid by the government = 6.0%)

LR nominal GDP growth (% y/y)	Primary surplus for debt-GDP ratio at 150% of GDP	Primary surplus for debt-GDP ratio at 115% of GDP
-1.0	10.6	12.3
0.0	9.0	10.6
1.5	6.7	8.7
2.5	5.1	7.3
4.5	2.2	4.6

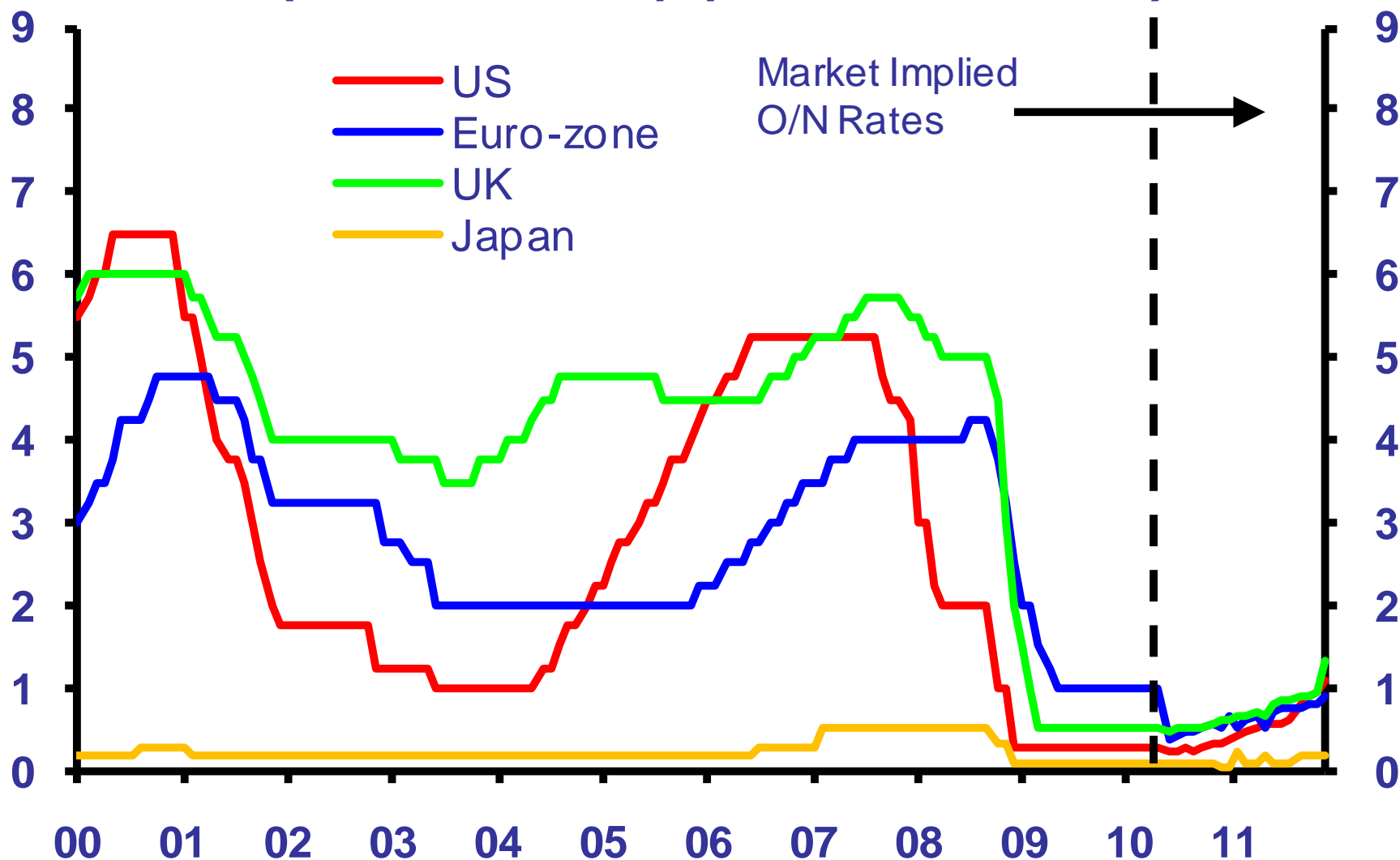
23. Real Effective Exchange Rates (Jan 1999 = 100) (Latest = Q1 2010)



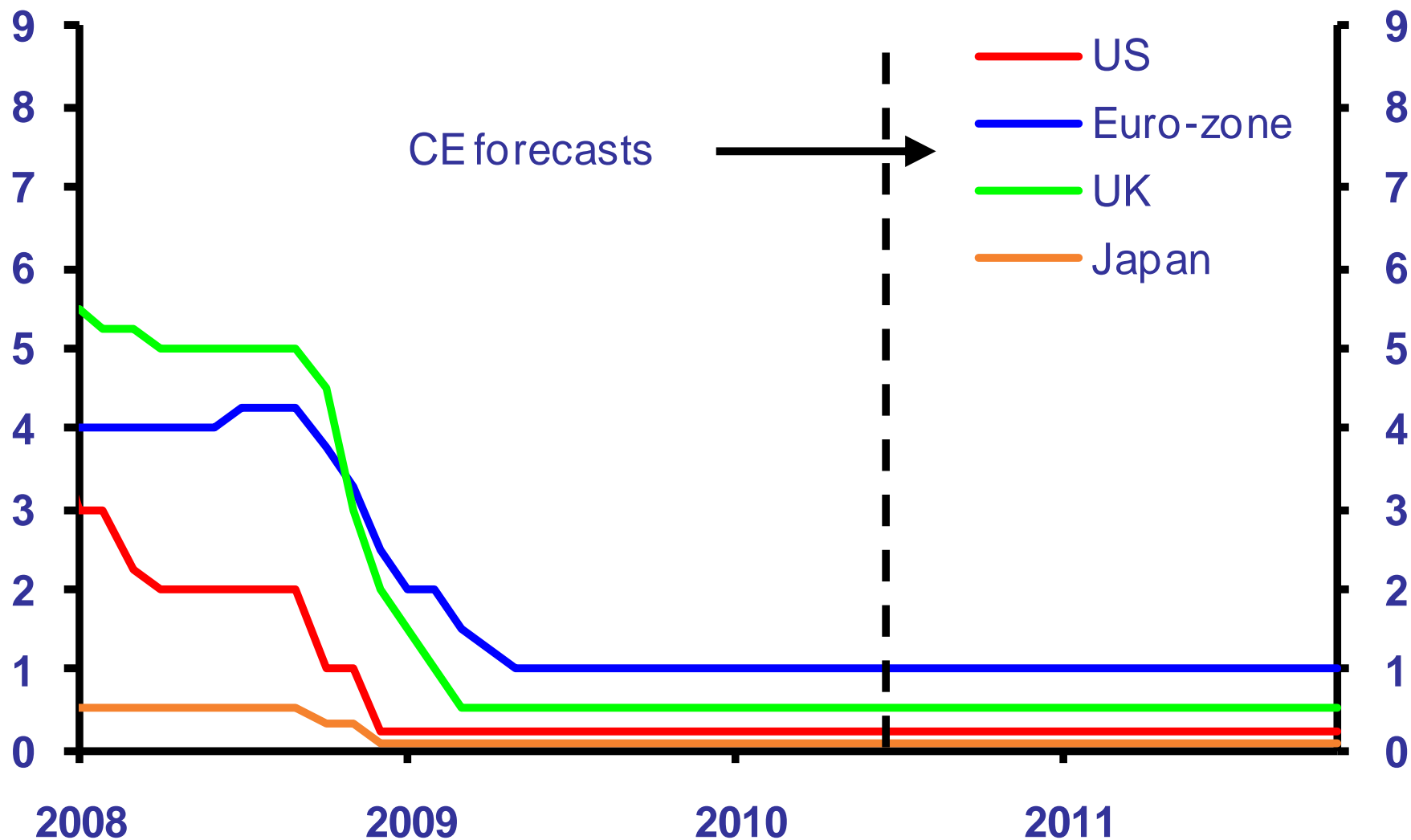
24. UK vs. Greece Fiscal Positions



25. Market Interest Rate Expectations (%) (2000 – 2011) (Latest = 1 Jun)



26. CE Interest Rate Expectations (%) (2008 – 2011)



27. Solutions

- **Most of the west, including the US needs to embark on fiscal tightening. If domestic demand is to be increased in the west then it must be mainly through higher corporate investment.**
- **Germany is a marked exception. She needs to boost consumption and possibly government spending.**
- **Most importantly, the world economy needs much higher domestic demand combined with higher exchange rates in Asia, led by China.**

28. Conclusions

- **The danger of a double dip has not receded.**
- **Sovereign defaults look more likely than not in the euro-zone.**
- **The euro is unlikely to survive in its current form.**
- **Most countries of the west face a long period of fiscal cuts.**
- **Inflation is likely to remain very low.**
- **In many countries deflation is the major threat.**
- **Equities look testingly valued in the US.**
- **In many countries there will be weakness in property prices.**
- **Interest rates are likely to remain low for several years, virtually everywhere in the west.**
- **It may take another leg to the financial crisis to force fundamental change.**

Is the Crisis Over?

By

Roger Bootle

